

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, Linda Breathitt,
and Nora Mead Brownell.

National Grid USA

Docket No. EL01-80-001

Alliance Companies

Docket Nos. RT01-88-005, RT01-88-012, ER99-
3144-013, ER99-3144-015, EC99-80-013, and
EC99-80-015

Ameren Corporation

on behalf of:

Union Electric Company

Central Illinois Public Service Company

American Electric Power Service Corporation

on behalf of:

Appalachian Power Company

Columbus Southern Power Company

Indiana Michigan Power Company

Kentucky Power Company

Kingsport Power Company

Ohio Power Company

Wheeling Power Company

Consumers Energy Company

and Michigan Electric Transmission Company

Exelon Corporation

on behalf of:

Commonwealth Edison Company

Commonwealth Edison Company of Indiana, Inc.

FirstEnergy Corp.

on behalf of:

American Transmission Systems, Inc.
The Cleveland Electric Illuminating Company
Ohio Edison Company
Pennsylvania Power Company
The Toledo Edison Company

Virginia Electric and Power Company

Illinois Power Company

Northern Indiana Public Service Company

The Dayton Power and Light Company

ORDER GRANTING IN PART AND DEFERRING IN PART REQUEST FOR DECLARATORY ORDER AND DISMISSING BUSINESS PLAN FILING

(Issued December 20, 2001)

In this order the Commission grants in part and defers in part the request of National Grid USA (National Grid) for a declaratory order in Docket No. EL01-80-001 that it is not a market participant, and therefore may serve as the managing member of the Alliance Regional Transmission Organization (Alliance or Alliance RTO). In a concurrently issued order in Alliance Companies, et al., Docket No. RT01-88-000, et al. (Alliance VI Order), __ FERC ¶ ____ (2001), we find that the interests of customers in the Midwest would best be served if Alliance Companies were to join the Midwest Independent System Operator (Midwest ISO) and direct Alliance Companies to explore membership in the Midwest ISO through Appendix I. To facilitate that process we find that it is appropriate to address various aspects of National Grid's petition and to grant the declaratory relief sought by National Grid in part, but to defer ruling on other aspects of National Grid's petition as discussed below. Similarly, as a result of our finding in the Alliance VI Order, we dismiss Alliance Companies' business plan filing for the Alliance RTO.

This order serves the public interest because it will promote the formation of a single Regional Transmission Organization (RTO) in the Midwest with appropriate scope.

I. Introduction

Today the Commission is acting on five interrelated orders intended to move the process forward in establishing an optimally sized RTO in the Midwest and to support the establishment of viable, for-profit transmission companies that operate under an RTO umbrella and may, depending on their level of independence from market participants, perform certain of the RTO functions contained in

the Commission's Order No. 2000.¹ In taking today's actions, we have made findings as to the RTO structure that we conclude best serves the public interest in the Midwest. Our decisions in these five orders recognize the realities and needs of the Midwestern wholesale electricity market and take into account the views of the Midwestern State commissions. However, our actions should not be construed to prejudge other types of RTOs in other parts of the country, including a structure in which a for-profit transmission company could be an umbrella RTO.

For two years now, since the issuance of Order No. 2000, electric industry participants in the Midwest, State commissions, and this Commission have struggled with an array of different proposals and issues and how best to achieve a seamless wholesale power market in the Midwest. While both the Midwest ISO and Alliance Companies have spent considerable money and resources in developing and attempting to reconcile their competing proposals, the Commission is at a point where we must make some difficult decisions with respect to the competing proposals. Based on the record before us, and taking into account the views of the majority of the Midwestern State commissions, we conclude that the Midwest ISO's proposal most fully complies with the vision and requirements of Order No. 2000, in particular the requirement that an RTO be of sufficient scope, and that the Midwest ISO therefore should serve as the foundation upon which a Midwest RTO should be built. In this regard, we are confident that Alliance Companies' desire to be a viable transmission business can be accommodated under the Midwest ISO umbrella.

In today's five orders, we take the following specific steps:

- (1) approve the Midwest ISO as an RTO (Docket No. RT01-87-000, et al.);
- (2) approve International Transmission Company's (International Transmission) request to transfer operational control of its transmission facilities to the Midwest ISO; and accept an agreement between International Transmission and the Midwest ISO that would allow International Transmission to be an independent transmission company that would share certain RTO functions with the Midwest ISO (Docket No. ER01-3000-000, et al.);

¹Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809 (January 6, 2000), FERC Stats. & Regs. ¶ 31,089 (1999) (Order No. 2000), order on reh'g, Order No. 2000-A, 65 Fed. Reg. 12,088 (March 8, 2000), FERC Stats. & Regs. ¶ 31,092 (2000) (Order No. 2000-A), aff'd sub nom. Public Utility District No. 1 of Snohomish County, Washington v. FERC, Nos. 00-1174, et al. (D.C. Cir., Dec. 11, 2001).

(3) preliminarily approve the disposition of International Transmission's transmission facilities to an unaffiliated entity with no ownership interest in a market participant, thus facilitating a stand-alone transmission company under the Midwest ISO umbrella (Docket No. EC01-137-000);

(4) conclude that Alliance Companies, which filed for approval as a separate RTO, lacks sufficient scope to exist as a stand-alone RTO; but direct Alliance Companies to explore how their business plan (including the proposal for National Grid to become the managing member of Alliance) can be accommodated within the Midwest ISO (Docket No. RT01-88-000, et al.); and

(5) grant in part and defer in part National Grid's request for a declaratory order that it is not a market participant and dismiss Alliance Companies' business plan (Docket No. EL01-80-001, et al.).

We now turn to the specific actions taken in the above captioned dockets.

II. Background

On July 12, 2001, the Commission issued an order addressing the RTO compliance filing by Alliance Companies.² In the July 12 Order, the Commission noted that one of the business plan options proposed by Alliance Companies was to choose a strategic investor to both invest in and serve as managing member of Alliance RTO, at least for a transitional period, and that its ultimate view of whether such an investor was sufficiently independent from Alliance to serve as managing member would depend on "the exact nature of the final proposal made by Alliance Companies."³

The Commission also noted that it was concerned that business decisions were being made by Alliance Companies prior to implementation of an Alliance RTO, and thus directed Alliance Companies to decide which business plan they intended to implement within 45 days of the order. The

²The Alliance Companies are: Ameren Corporation on behalf of Union Electric Company, Central Illinois Public Service Company; American Electric Power Service Corporation on behalf of Appalachian Power Company, Columbus Southern Power Company, Indiana Michigan Power Company, Kentucky Power Company, Kingsport Power Company, Ohio Power Company, Wheeling Power Company; Consumers Energy and Michigan Electric Transmission Company, Exelon Corporation on behalf of Commonwealth Edison Company, Commonwealth Edison Company of Indiana, Inc.; FirstEnergy Corp. on behalf of American Transmission Systems, Inc., The Cleveland Electric Illuminating Company, Ohio Edison Company, Pennsylvania Power Company, The Toledo Edison Company; Virginia Electric and Power Company, Illinois Power Company, Northern Indiana Public Service Company, and The Dayton Power and Light Company.

³96 FERC ¶ 61,052 at 61,129-30, 61,134 (2001) (July 12 Order).

Commission further directed that, from the date of the order, Alliance Companies must establish an independent board to make all business decisions for the RTO, citing to GridFlorida LLC, et al.⁴

2. On May 15, 2001, National Grid filed a petition for a declaratory order, asking the Commission to find that National Grid would not be deemed a market participant and so would be eligible to serve as Alliance's managing member. National Grid represented that it is not a market participant, and has no economic or commercial interests regarding the Alliance region that would render it a market participant. National Grid asserted that it is not an incumbent utility serving load within the Alliance RTO, and that it makes power sales and has generating interests solely in New York and New England, areas that are remote from the Alliance RTO territory. According to National Grid, its power sales in New York and New England are made solely for purposes of fulfilling National Grid's or its subsidiaries' provider of last resort (PoLR) obligations at retail and for certain wholesale power obligations which are in the process of being terminated. National Grid further asserted that it is currently divesting its remaining generation resources.

In an order issued on July 26, 2001,⁵ the Commission addressed National Grid's petition. The Commission noted that providers of last resort service are considered market participants because they are sellers of electric energy. However, certain factors (such as the fact that an entity's sole electric sales were made to satisfy a state requirement and it does not actively compete for retail load) could support a finding that the entity is not a market participant. However, the Commission concluded that significant questions had been raised regarding the independence of National Grid which needed to be addressed before ruling on National Grid's petition for a declaratory order. The Commission thus deferred ruling on National Grid's request for declaratory relief, but allowed it to supplement its filing to demonstrate how it meets Order No. 2000's independence requirement. In particular, the Commission required National Grid to address four specific topics, as discussed in the following section of this order. On August 27, 2001, National Grid made a supplemental filing with the Commission in response to the July 26 Order (August 27 Filing). On November 15, 2001, National Grid filed a letter with the Commission informing it of further developments (November 15 Letter).

3. In response to the Commission's four questions, National Grid provided the following information:

- (1) How are the generation resources that National Grid or its affiliates own or control committed to its PoLR function or otherwise consistent with the definition of market participant? (The Commission also required National Grid to update the information provided in its petition regarding changes in the generation resources that National Grid or its affiliates own or control.)

⁴94 FERC ¶ 61,363 at 62,325 (2001) (GridFlorida).

⁵National Grid USA, 96 FERC ¶ 61,121 (2001) (July 26 Order).

In New York, National Grid is in the process of merging with Niagara Mohawk Holdings (Niagara Mohawk),⁶ and has reached agreement with the New York Public Service Commission (New York Commission) staff on the conditions under which the merger is authorized (November 15 Letter). Niagara Mohawk has now sold its interests in the Nine Mile Nuclear Units, which were used to support Niagara Mohawk's PoLR service. Two buy-back contracts for 980 MW in purchases from Nine Mile have become effective. Niagara Mohawk also holds power purchase contracts for another 3,764 MW of capacity which supports Niagara Mohawk's PoLR service, its one wholesale requirements sale of 5 MW, and sales to end-use customers under borderline agreements with surrounding utilities.⁷ National Grid states (in the August 27 Filing) that as of September 1, 2001, Niagara Mohawk will not have an economic interest in the purchases it makes or its sales to last resort customers, the wholesale requirements customer and borderline customers because, under a tariff mechanism, the costs and revenues associated with supplying power to these customers will be fully reconciled such that Niagara Mohawk neither makes nor loses money on the sales. Also, Niagara Mohawk entered into agreements with Tractebel Energy Marketing, Inc. (Tractebel), under which Tractebel would purchase all the power available under the majority of Niagara Mohawk's power purchase contracts and financial agreements and Niagara Mohawk would outsource to Tractebel the responsibility for obtaining the power required to meet all of its retail load obligations (August 27 Filing). National Grid now states in the November 15 Letter that the Tractebel agreements have been terminated, and National Grid is currently analyzing other options to transfer the power supply responsibility of meeting Niagara Mohawk's PoLR obligations to a third party once National Grid acquires Niagara Mohawk.

According to its August 27 Filing, in New England, National Grid's subsidiary, New England Power (NEP), still owns 289.5 MW of generation through its interests in two nuclear plants (Vermont Yankee and Seabrook) and one oil-fired unit (Wyman 4) and has a contractual entitlement to purchase 59 MW of power from the Pilgrim nuclear unit in 2002, declining to 37 MW in 2003-4 when the agreement terminates. A small amount of NEP's resources has supported NEP's obligation to supply power for last resort service provided by Narragansett Electric Company (Narragansett), a National Grid subsidiary in Rhode Island, and the remainder (222.7 MW) is sold to wholesale purchasers. National Grid stated in the August 27 Filing that it anticipates selling NEP's interest in Vermont Yankee to Entergy by spring 2002, its interest in Seabrook will be sold at auction under the supervision of the New Hampshire Public Utilities Commission, with the sale expected to close by the end of 2002, and it is continuing to seek an unaffiliated third party to purchase its Wyman interest. National Grid commits

⁶National Grid's acquisition of Niagara Mohawk Holdings, the parent corporation of Niagara Mohawk, has been approved by the Commission, but has not yet been consummated. See Niagara Mohawk Holdings, Inc. and National Grid USA, 95 FERC ¶ 61,381, reh'g denied, 96 FERC ¶ 61,149 (2001).

⁷See August 27 Filing, Matrix of Resources, Obligations and Marketing Interests (Matrix) attached to the transmittal letter.

that, until its economic interests in its generation resources and associated sales obligations terminate, it will transfer those economic interests to one or more unaffiliated third parties on or before the date on which Alliance Companies would begin operating as an RTO. NEP's obligation to provide Narragansett with power to meet its last resort service in Rhode Island terminated as of December 1, 2001, after Narragansett entered into a contract with an unaffiliated third party to supply power to meet its last resort load (November 15 Letter). National Grid's distribution subsidiaries in New England also purchase 5 MW of power from Qualifying Facilities (QFS) as required by PURPA.⁸ National Grid states that the sellers of that power are paid what the distribution companies receive for the sale of the power in the ISO New England market, and National Grid thus has no economic interest in those sales.

- (2) How will National Grid ensure that, if it or its affiliates own or control Niagara Mohawk's marketing affiliates, that relationship will not create economic or commercial interests that would be significantly affected by the Alliance RTO's actions or decisions?

Niagara Mohawk's proposed sale of one of its power marketing affiliates, Niagara Mohawk Energy Marketing, Inc. (NMEM), to Select Energy, Inc., was approved by the Commission by letter order on November 16, 2001. If Niagara Mohawk fails to similarly sell its other power marketing interest in Canadian Niagara Power Company (Canadian Niagara), National Grid intends to put into place mechanisms to ensure that it will have no economic or commercial interest in Canadian Niagara that may be affected by the markets (August 27 Filing).

- (3) How do National Grid's responsibilities as supplier of last resort fulfill the criteria of Order Nos. 2000 and 2000-A not to be considered a Market Participant?

National Grid's distribution subsidiaries in New York and New England provide PoLR service. National Grid notes that in Order No. 2000, the Commission stated that it would consider finding that an entity is not a market participant with respect to last resort sales if the sales are made pursuant to a state requirement and the entity does not compete for retail load. National Grid alleges that its distribution subsidiaries' PoLR sales meet this standard.

National Grid states that as of September 1, 2001, Niagara Mohawk has no economic interest in its last resort sales to 68 percent of its distribution load, its 5 MW wholesale sale to the Village of Bergen (which terminates in 2003) and its sales to 147 end-use customers under borderline agreements with surrounding utilities, because under a mechanism in its retail tariff all costs and revenues will be true-up (Matrix). Niagara Mohawk will flow through to customers all of the costs incurred to supply its load. Further, National Grid contends that Niagara Mohawk provides last resort service pursuant to the policies of the New York Commission and does not compete for retail load (November 15 Letter).

⁸The Public Utility Regulatory Policies Act, 16 U.S.C. 824a-3.

Before the termination of the Tractebel agreement, National Grid had committed that all responsibility for supplying power necessary to serve Niagara Mohawk's last resort load would be transferred to Tractebel until December 31, 2006. As noted above, National Grid is now seeking other options to accomplish the Tractebel agreement's purposes.

National Grid also makes small sales to other customers (11.9 MW to Vermont Yankee Secondary Purchasers, 4.9 MW to Unitil, 3 MW wholesale sale to three FERC Tariff 1 customers, and 1.4 MW to American Tissue). These sales obligations will terminate between 2001 and 2005 (Matrix). National Grid also states that its New England distribution subsidiaries similarly do not compete for retail load. National Grid states that these subsidiaries have mechanisms in place to fully reconcile their costs with their revenues, so that they can earn no profits and have no risks. In addition, the distribution subsidiaries have contracted with third parties to provide the power for their PoLR sales and to interact with the market concerning the supplies necessary to meet the load (August 27 Filing and November 15 Letter).

- (4) The Commission also required National Grid to undertake efforts to reduce the extent of the retail market it serves in Western New York, or to separate its retail interests in that market from the business of being Alliance's managing member.

National Grid maintains that Niagara Mohawk has in place programs to encourage migration of last-resort customers to competitive suppliers, which National Grid will not reduce or weaken (August 27 Filing). National Grid states that under the National Grid/Niagara Mohawk proposal currently under review by the New York Commission, National Grid will (i) provide credits through 2011 to customers who switch to another supplier, (ii) retain the current rate design by which large industrial and commercial customers are exposed to the volatility of the New York day ahead market price (so that such customers will have an incentive to switch to competitive suppliers if they desire fixed prices)⁹ and (iii) switch more customers to that rate design (November 15 Letter). Under this same proposal, Niagara Mohawk will implement a program to provide opportunities for other suppliers to exchange information with customers, and coordinate the registration of marketers and customer transfer requirements in its combined service areas in New York and New England to better enable marketers to sell to National Grid's last resort customers (November 15 Letter). National Grid alleges that as a result of these programs, 59 percent of Niagara Mohawk's distribution load will be supplied by parties other than National Grid at rates that expose the customers to market volatility, and the other 41 percent will be supplied under a rate design that only partially reduces the customers' exposure to volatility; National Grid anticipates that these customers will thus be incented to switch to a competitive supplier (November 15 Letter).

⁹Niagara Mohawk's standard rate customers, which constitute most of its load, also became subject to market price volatility after September 1 and thus have a similar incentive to switch to competitive suppliers (August 27 Filing).

4. Alliance Companies' Business Plan Filing

On August 27, 2001, Alliance Companies filed a business plan in Docket Nos. RT01-88-005, ER99-3144-013 and EC99-80-013 in response to the directives set forth by the Commission in the July 12 Order. Alliance Companies state that they would choose a strategic investor, namely, a non-market participant that has experience and expertise in transmission or a related business, that would make an equity investment in and become the managing member of Alliance Transco.¹⁰ Alliance Companies proposed that this strategic investor would be National Grid.

Under the business plan, once National Grid's independence is established, it would assume responsibility for making all decisions for the Alliance RTO. Upon the formation of Alliance Transco Limited Liability Company, National Grid would make an investment in, and, through a direct or indirect wholly-owned subsidiary, serve as the managing member of Alliance. National Grid could own transmission assets within Alliance and would manage those assets, as well as other transmission assets owned by Alliance itself and transmission assets of other, non-divesting transmission owners (NDTOs), i.e., utilities that retain ownership of their transmission facilities but transfer functional control to Alliance. Under the business plan, the NDTOs will have a contractual relationship with Alliance (rather than an equity interest in Alliance), and Alliance, through its managing member National Grid, will functionally control the transmission facilities of the NDTOs and act as the NDTOs' agent in collecting and remitting revenues to them.

III. Discussion

A. Procedural Issues

Notice of National Grid's supplemental filing in Docket No. EL01-80-001 was published in the Federal Register, 66 Fed. Reg. 48043 (2001), with interventions, comments, or protests required to be filed on or before September 21, 2001. Numerous interventions and protests were filed. On October 5, 2001, National Grid filed a response to the comments and protests.

Notice of Alliance Companies' filing in Docket No. RT01-88-005, et al. was published in the Federal Register, 66 Fed. Reg. 46,448 (2001), with interventions, comments, or protests due on or before September 17, 2001. Numerous interventions and protests were filed. On October 5, 2001, Alliance Companies filed an answer.

¹⁰On November 1, 2001, in Docket No. RT01-88-012, et al., Alliance Companies and National Grid filed proposed definitive agreements (Participation Agreement, LLC Agreement, Operation Agreement, and Master Agreement) which would establish National Grid as the managing member of Alliance Transco and establish Alliance Transco as the Alliance RTO.

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2001), the notices of intervention and timely unopposed motions to intervene serve to make the state commissions and movants, respectively, parties to this proceeding. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2000), the Commission will grant the late-filed motions to intervene given the fact that no disruption of the proceeding or undue prejudice to existing parties will result, and the late-filing parties' interests are not adequately represented by other parties in the proceeding. Under Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2)(2001), a party may not file an answer to a protest unless the decisional authority so orders. Given the complex nature of this proceeding and because the answers have aided us in clarifying certain issues, we will accept National Grid's answer in Docket No. EL01-80-001 and Alliance Companies' answer in Docket No. RT01-88-005, et al.

B. Commission Determination

We note that in a concurrently issued order in Docket No. RT01-88-000 et al. the Commission finds that the interests of customers in the Midwest would best be served if Alliance were to join the Midwest ISO and directs Alliance Companies to explore how their business plan (including National Grid) can be accommodated within the Midwest ISO, e.g., via Appendix I, which creates a framework for membership and operation of independent transmission companies within the Midwest ISO. In order to facilitate the integration of Alliance into the Midwest ISO, we will address independence issues related to National Grid's affiliates' last resort sales and other obligations, and the adequacy of National Grid's commitments with respect to those sales and obligations.

Independence of National Grid.

Intervenors continue to argue that National Grid is a market participant and should not be declared eligible to manage Alliance. They raise concerns primarily in four areas: (1) National Grid's last resort sales or obligations and the adequacy of its proposed mechanisms for transfer of the associated power supply responsibilities; (2) the need to complete mechanisms for transfer of power supply responsibilities for PoLR service before granting non-market participant status; (3) conflicts of interest between National Grid's role as operator of Alliance and owner of transmission interests in New York and New England; and (4) conflicts of interest arising from National Grid's multiple roles within Alliance as investor, transmission owner, and managing member of Alliance.

- 1) Adequacy of Steps that National Grid Has Taken to Ensure that Its Last Resort Sales and Other Obligations Do Not Render It a Market Participant.

Trans-Elect and other protestors claim that notwithstanding the Tractebel agreements,¹¹ National Grid will still have a strong incentive to manage the Alliance transmission system to benefit its PoLR obligations in New York and New England. The Ohio Consumers Counsel (OCC) and Coalition of Midwest Transmission Customers and Industrial Energy Users - Ohio (Ohio Coalition) argue that if the unaffiliated third parties with whom National Grid contracts to perform its last resort service should default on those agreements, Niagara Mohawk will again be responsible for performing last resort service; thus, National Grid will be motivated to ensure those third parties' solvency and continued ability to fulfill the agreements to maintain reliable service. Trans-Elect and International Transmission further argue that, despite National Grid's statements that outsourcing the supply responsibility for Niagara Mohawk's PoLR obligations to other companies will transfer all the risks and rewards of providing that service to those companies, in fact, Niagara Mohawk will still be required to demonstrate to the New York Commission that the costs it incurs to purchase power to meet its last resort obligations are prudently incurred, or else have them disallowed: thus, again, National Grid would have an incentive to operate Alliance in such a way as to favor the third parties to whom it outsources its supply responsibilities for PoLR service. Therefore, according to Trans-Elect, National Grid falls within the definition of a market participant as an "entity that . . . has economic or commercial interests that would be significantly affected by the [RTO's] actions or decisions."¹²

Protesters also suggest that where purchases used to serve National Grid's last resort load are exposed to market fluctuations, National Grid will have an incentive to encourage entry of more supply into New York and to inhibit delivery of power from New York to other areas in order to keep New York prices low. Alternatively, they assert that where the supplies have been fully hedged, National Grid would be encouraged to frustrate deliveries of power from the Alliance region into New York to keep prices high. PJM notes, given the current limited state of competition in New York and New England, that it will require a long-term effort to persuade National Grid's customers to migrate to other suppliers, and Trans-Elect also points out that Niagara Mohawk's efforts in this regard are only directed towards business, municipal and street lighting customers, and not towards large industrial or residential customers. And finally, OCC and Trans-Elect assert that the mechanisms developed by National Grid to ensure that it does not benefit from its last resort service are so complex that they will require constant policing by the Commission.

In response, National Grid states that the argument that its outsourcing agreements create an incentive for National Grid to favor the third parties to whom it outsources the supply responsibility for its PoLR obligations would lead to the conclusion that a transco, or any RTO, cannot have a contractual relationship with any market participant. This, according to National Grid, would conflict with the Commission's statement in Order No. 2000-A that an entity may be deemed not a market

¹¹Now that the Tractebel transaction has been terminated, the arguments with regard to that specific transaction are moot.

¹²18 C.F.R. § 35.34(b)(2)(ii) (2001).

participant if its sole electric sales are to satisfy a state requirement and it does not compete for retail load.

In response to the argument that National Grid would be required to favor those entities to whom it outsources the supply responsibility for its PoLR obligations in order to be found prudent, National Grid states that it is required to treat all customers on a non-discriminatory basis, and that, in any event, no state commission would find prudent any actions by National Grid which violated its non-discrimination obligations. National Grid also asserts that, by outsourcing its subsidiaries' supply obligations for PoLR service to other parties it will transfer to those parties the need to interact with the market to acquire energy for PoLR service. Further, National Grid asserts that it is attempting to persuade last resort customers to migrate to other providers, consistent with the Commission's directive that it reduce the extent of the retail market it serves in Western New York. Finally, with regard to the argument that National Grid's arrangements will require extensive policing, National Grid disagrees and argues that the RTO's market monitor will be able to determine if National Grid is favoring any market participant.

Commission Conclusion

We find that, given the specific circumstances of this case, National Grid has demonstrated that it is not a market participant with respect to its last resort sales and other obligations in New York and New England. As we reiterated in the July 26 Order, we had "stated in Order No. 2000 that, while providers of last resort are included in the Market Participant definition because they are sellers of electric energy, 'the Commission believes that certain factors (e.g., an entity's sole electric sales are made to satisfy a state requirement and it does not compete for retail load) would support a finding that the entity is not a market participant.'"¹³ As noted above, the majority of the sales by National Grid's subsidiaries are made for the purpose of providing last resort service. Moreover, National Grid's subsidiaries do not compete for new load, and in fact are seeking to migrate their current customers to other suppliers. In addition, while National Grid's subsidiaries Niagara Mohawk and NEP have certain continuing sales unrelated to their PoLR obligations, these sales are generally for small amounts and will terminate no later than 2005, and National Grid has taken steps or is in the process of taking steps to ensure that it has no economic interest in these sales. Further, as detailed above, we agree with National Grid that its sales activities in New York and New England will have no economic impact on it because all revenues and costs will be fully reconciled, so that there will be no opportunity for either profits or losses.¹⁴ As further protection, National Grid commits to transfer its responsibilities under its

¹³96 FERC at 61,528, citing Order No. 2000 at 31,063.

¹⁴Trans-Elect suggests that some of the rates charged by National Grid's New England subsidiaries are at fixed levels which are not necessarily tied to the costs of purchasing power. However, National Grid points out that the distribution subsidiaries' rates are adjusted to reflect costs, (continued...)

PoLR service to unaffiliated third parties. Based on these facts, including National Grid's commitment to ensure that it has no economic interest in these sales, we find that the sales do not confer market participant status on National Grid.

We also reject protesters' arguments that National Grid will have an incentive to operate Alliance so as to favor the third parties to whom it has outsourced its PoLR responsibilities, or to treat those parties differently from other market participants. National Grid's proposal to outsource its PoLR responsibilities is consistent with our finding that an entity owning generation interests can avoid being considered a market participant by transferring to a non-affiliated entity both the marketing rights and any profits resulting from the sale of electric energy associated with its ownership.¹⁵

In response to arguments regarding the prudence of entering into buy-back agreements, we note that prudence is evaluated using the "reasonable man" standard. Under this standard, the prudence of an action is determined by examining the decision-making process at the time the decision was made. Hindsight is not a part of the analysis.¹⁶ Therefore, it would be unnecessary for National Grid to try to manipulate prices in New York and New England to support the reasonableness of having entered into the buy-back contracts.

2) Appropriateness of Granting Approval before Transitional Mechanisms are in Place

¹⁴(...continued)
based on provisions in their retail tariffs.

¹⁵Order No. 2000 at 31,063.

¹⁶See In the Matter of Consolidated Edison Company of New York, Inc.'s Plans for (1) Electric Rate/Restructuring Pursuant to Opinion No. 96-12; and (2) the Formation of a Holding Company, Case 96-E-0897, et al.; Opinion No. 97-16, New York Public Service Commission, 1997 N.Y. PUC LEXIS 661 at 61 n. 3 (November 3, 1997), citing Case 27123, Consolidated Edison Company of New York, Inc. Indian Point No. 2 Outage, Opinion No. 79-1 (issued January 16, 1979), mimeo p. 6 ("The company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problems prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company"). See also Iroquois Gas Transmission System, L.P., 87 FERC ¶ 61,295 at 62,170 (1999) ("In performing our duty to determine the prudence of specific costs, the appropriate test to be used is whether they are costs which a reasonable utility management (or that of another jurisdictional entity) would have made, in good faith, under the same circumstances, and at the relevant point in time. We note that while in hindsight it may be clear that a management decision was wrong, our task is to review the prudence of the utility's actions and the costs existing either at the time the challenged costs were actually incurred, or the time the utility became committed to incur those expenses," citations omitted).

Trans-Elect, Ohio Coalition and OCC point out that National Grid has made several statements regarding what it intends to do to avoid conflicts of interest, but has not stated what it will do if it cannot put these particular transition mechanisms into place. OCC also states that, until National Grid actually puts these transition mechanisms into place, it will continue to be a generation owner and seller, and a purchaser of power for its subsidiaries' last resort obligations. Trans-Elect and Calpine argue that National Grid's commitments to have in place an unspecified mechanism to ensure that it will have no interest in its power marketer subsidiaries is too vague to support a finding that National Grid is not a market participant.

National Grid responds that it has a strong record in implementing its commitments, and that it is currently in the process of fulfilling the commitments it made in its Supplemental Filing. It notes that since making the Supplemental Filing, it has proceeded with the divestiture of generation by its subsidiaries NEP and Montaup Electric Company, and NEP is proceeding with its divestiture of its Vermont Yankee and Seabrook interests. Similarly, Niagara Mohawk has divested its non-nuclear assets and its interest in the Nine Mile nuclear units. Niagara Mohawk has sold its marketing affiliate, NMEM, and the only marketing interest that Niagara Mohawk still retains is its 50 percent interest in Canadian Niagara, which it is seeking to sell, and which in any case represents only approximately 19 MW out of a total market (Northeast and the Alliance RTO territory) of 212,000 MW.¹⁷

Commission Conclusion

While a finding of independence is contingent upon National Grid demonstrating that it has satisfied the commitments it has made, it is appropriate that National Grid be given guidance as to how the Commission will rule if it honors its commitments, and we do so in this order. By providing this guidance now we hope to facilitate the incorporation of Alliance Companies into the Midwest ISO. We note that National Grid has already fulfilled its outsourcing commitments for PoLR service in New England. In addition, Select Energy (the purchaser of NMEM) notified the Commission that the transaction closed on December 1, 2001.

3) National Grid's Dealings with Other RTOs and Effects on Its Transmission and Distribution Interests in New York and New England

¹⁷Under the terms of Niagara Mohawk's agreement with the other owner of Canadian Niagara, each owner can require the other owner to buy its interest. National Grid states that when the merger with Niagara Mohawk is consummated, it will require the other owner to buy all of National Grid's shares in Canadian Niagara, or, if the other owner exercises this option first and requires National Grid to buy all of its shares, then National Grid will ultimately sell Canadian Niagara and put interim measures in place to ensure that it has no economic interest in Canadian Niagara.

PJM, Calpine and PSEG argue that National Grid's filings fail to reconcile the potential conflicts arising from National Grid's position as a transmission owner in Alliance and Alliance manager with its role as a transmission owner in New York and New England. PJM and Calpine note that as the Alliance operator National Grid will need to address interregional coordination issues (such as loop flows, rate design, reciprocity, interface management and transmission improvements) with adjoining grid operators in PJM and the New York Independent System Operator (NYISO), or possibly a single Northeast RTO. They argue that as a purportedly independent RTO operator, National Grid should not be permitted to participate on both sides of the debate on these critical issues and thus influence an outcome that will directly affect its substantial transmission interests in New York and New England. For example, PJM questions how National Grid could react independently to generator interconnection requests in the Alliance RTO that improve transmission conditions in Alliance but reduce the need for transmission interconnections to the Northeast. PJM suggests that National Grid would not be able to independently decide among alternative interregional transmission improvements, some of which might affect transmission flows and revenues in the Northeast. Further, PSEG asserts that National Grid's multiple roles as Alliance operator and transmission owner in both New York and New England will provide it significant influence over the Midwest, Mid-Atlantic and Northeast regional transmission systems. Trans-Elect similarly contends that National Grid will have a natural tendency to retain or attract industrial customers in western New York in order to maximize the value of its distribution assets, and thus may operate Alliance to ensure that such customers have adequate and reasonably-priced access to transmission service.

National Grid disputes the assertion that it will have an incentive to use its position as the Alliance operator to affect transmission flows within New York and New England. According to National Grid, under the NYISO tariff, Niagara Mohawk's transmission revenues are limited to Niagara Mohawk's Commission-established revenue requirement under a cost-of-service tariff and, at the retail level, wholesale transmission revenues are fully credited to retail ratepayers. Similarly, National Grid states that NEP's transmission rates are established under a cost-of service formula-rate tariff so that changes in transmission flows do not affect NEP's earnings.

Commission Conclusion

In a concurrently issued order, we are establishing the Midwest ISO as the RTO for the Midwest and directing Alliance Companies to explore membership in the Midwest ISO. Until Alliance Companies develop a new business plan for their membership in the Midwest ISO as an Appendix I entity, the Commission will not have before it a plan showing what functions National Grid would perform as the manager of an Appendix I entity. Until those functions become clear, it is premature to rule on the interregional aspects of the proposal to have National Grid serve as the managing member of Alliance. The Commission will therefore defer ruling on this question until it has before it a filing stating what functions National Grid will perform for Alliance Companies' Appendix I entity within the Midwest ISO.

4) National Grid's Multiple Roles within Alliance

Mirant Neenah, LLC, Mirant State Line Ventures, Inc., and Mirant Zeeland, LLC (Mirant) argues that permitting National Grid to be Alliance's managing member, while it is an equity participant in Alliance and owns transmission assets within Alliance, is contrary to the requirements of Order No. 2000 and would undermine Order No. 2000's goals. It notes that the Commission requires RTOs to be independent of market participants, both in reality and in perception. Mirant and International Transmission view allowing National Grid to both own and operate transmission facilities within Alliance as a movement away from placing control in independent hands. Trans-Elect, International Transmission, Mirant and OCC all contend that National Grid, as a for-profit entity, will have an incentive to manage Alliance's transmission system so as to favor its transmission assets within Alliance over those of other Alliance participants. They argue that National Grid can do so by managing ratings and maintenance schedules so as to minimize costs related to its facilities, using its control of Available Transmission Capability (ATC)/Total Transmission Capability (TTC) calculations to benefit its own assets, constructing new transmission facilities intertwined with its existing facilities to increase profits from those facilities, and directing the construction and location of new transmission and generation to increase flows over its facilities and increase its revenues under Alliance's proposed flow-based rate methodology. Mirant, PSEG and OCC also assert that when confronted with transmission congestion, National Grid will have an incentive to choose transmission solutions over generation solutions, such as generator redispatch.

International Transmission and Trans-Elect further complain that National Grid's right of first negotiation will lower the price at which National Grid may acquire facilities, and that as operator of Alliance, National Grid will be in a position to take actions (such as manipulating ATC postings) to lower the value of facilities before it acquires them, and then afterwards take actions to increase the value of the same facilities.

In response, National Grid contends that denying its petition on the grounds that it owns transmission assets within Alliance and will have an incentive to favor those assets in its management of Alliance contradicts existing Commission policy and would inhibit the formation of for-profit transcos. This result, National Grid argues, would force transmission owners to transfer control of their facilities to operators who have no incentive to manage the assets efficiently and would also discourage the investment of capital from the transmission sector.

National Grid points out that the Commission made clear in Order No. 2000 that it would accept transcos as RTOs, as long they met the minimum characteristics and functions and other requirements,¹⁸ and clarified in Order No. 2000-A that an entity would not be deemed a market participant simply by providing transmission service, and a pure transmission company would not be

¹⁸Order No. 2000 at 31,036.

deemed to be a market participant solely because of its ownership of transmission facilities.¹⁹ National Grid asserts that, because an entity which is not a market participant may operate an RTO and an entity which merely owns transmission facilities is not a market participant, then an entity which merely owns transmission facilities may operate an RTO. National Grid claims that the Commission approved the strategic investor/managing member structure in the July 12 Order,²⁰ when it found no basis to conclude that this structure would give rise to a less independent RTO than an immediate initial public offering. The Commission noted that, in both cases, investors other than market participants would be the operator and principal owners of the RTO. National Grid states that if an RTO cannot rely on the Commission's prior orders, progress will stop; further, considerable expenditure of money and time was necessary to implement the strategic investor/managing member structure and that time and money will have been wasted if the Commission now changes its policy.

National Grid also rejects assertions that it would favor transmission solutions over generation solutions, and argues that more transmission investment should increase the opportunities for new generation investment. National Grid notes that in *Bangor Hydro-Electric Co., et al.*,²¹ the Commission held that any perceived bias of an RTO owner and operator to build transmission can be avoided through a properly structured incentive rate proposal. In addition, National Grid contends that Alliance's Planning Protocol requires it to regularly publish a forward-looking assessment of transmission system needs, which will inform market participants about system limitations and enable them to site new generation to eliminate transmission constraints. National Grid notes that the regional planning process will be open and transparent, with all decision-making available for review and Commission appeal, and that the transco would only invest in new transmission if the market fails to provide timely solutions, since unnecessary investment would place its earnings under performance-based rates at risk or be subject to possible disallowance on a prudence basis.

National Grid asserts that the argument that it would discriminate in favor of the portions of the Alliance transmission system it owns is equivalent to objecting to the Alliance Transco owning some, but not all of the RTO's transmission facilities. According to National Grid, the Commission has already accepted this basic feature of the Alliance RTO, as well as holding that transcos will be capable of preventing discrimination, citing *GridFlorida* and *Commonwealth Edison Company*.²² National Grid also points to provisions of the Operating Protocol and Planning Protocol which address intra-RTO discrimination by requiring equitable operational planning with active participation by transmission owners, detailed record-keeping, and mutually acceptable rules. National Grid states that the

¹⁹Order No. 2000-A at 31,362.

²⁰96 FERC at 61,134.

²¹96 FERC ¶ 61,063 at 61,272 (2001) (*Bangor Hydro*).

²²91 FERC ¶ 61,178 (2000) (*ComEd*).

independent market monitor will also have access to this data for its oversight purposes, as will the Alliance company transmission owners. Finally, National Grid asserts that it has no incentive to discriminate, since doing so would place its business interests in operating transmission facilities elsewhere in the world in jeopardy.

Commission Conclusion

Just as it is premature to rule on the interregional aspects of the proposal to have National Grid serve as the managing member of Alliance in advance of Alliance Companies' submitting a filing to become an Appendix I company within the Midwest ISO, it is also premature to address arguments related to the multiple roles that National Grid intends to assume within Alliance. Therefore, the Commission will also defer ruling on this question until the Alliance Companies have made such a filing.

Alliance Companies' Business Plan.

As a result of our finding in the Alliance VI Order, which establishes the Midwest ISO as the RTO for the Midwest and directs Alliance Companies to explore membership in the Midwest ISO, we will dismiss Alliance Companies' business plan without prejudice to their filing a reconstituted business plan when they make their Appendix I filing.

The Commission orders:

(A) The Commission grants in part and defers in part National Grid's request for a declaratory order, as discussed above.

(B) The Commission dismisses Alliance Companies' business plan filing in Docket No. RT01-88-005, et al. , and the definitive agreements filed by Alliance Companies and National Grid in Docket No. RT01-88-012, et al., as discussed above.

By the Commission. Commissioner Breathitt dissented in part
with a separate statement attached.

(S E A L)

Linwood A. Watson, Jr.,
Acting Secretary.

Appendix A

The listed parties have filed notices of intervention, motions to intervene, protests, or comments in Docket No. EL01-80-001 and Docket No. RT01-88-005, et al. Short-hand references to parties referred in the order are indicated in parenthesis after the name. Late interventions are indicated by an asterisk.

Intervenors in Docket No. EL01-80-001

Public Utilities Commission of Ohio (Ohio Commission)

Indiana Office of Utility Consumer Counselor

Illinois Commerce Commission (Illinois Commission)

Midwest Independent System Operator (Midwest ISO)

Williams Energy Marketing and Trading

Alliance Companies

Hydro One, Inc. (Hydro One)

PJM Interconnection, LLC (PJM)

Massachusetts Municipal Wholesale Electric Company (MMWEC)

Northeast Utilities Service Company (NUSCO)

Mirant Neenah, LLC, Mirant State Line Ventures, Inc., and Mirant Zeeland, LLC (Mirant)

Coalition of Midwest Transmission Customers and Industrial Energy Users - Ohio (Ohio Coalition)

Fourth Branch Associates (Fourth Branch)

The PSEG Companies (PSEG)

International Transmission Company (International)

Calpine Corporation (Calpine)

Trans-Elect, Inc. (Trans-Elect)

Enron Power Marketing (Enron)

Ohio Consumers Counsel (OCC)*

Dominion Virginia Power*

TransÉnergie U.S., Ltd.

Intervenors in Docket No. RT01-88-005, et al.

Calpine

Coalition of Municipal and Cooperative Users of Alliance Companies' Transmission (Coalition)

Duke Energy North America, LLC, Reliant Energy Power Generation, Inc., and Edison Mission Energy (collectively, Generators)

Enron

Illinois Commission*

Illinois Commission, the Michigan Public Service Commission, and the Public Utilities Commission of Ohio (collectively, Midwest State Commissions)

Mirant

National Grid USA (National Grid)

The New Power Company (New Power)

North Carolina Electric Membership Corporation (NCEMC)

NRG Power Marketing, Inc., NRG Granite Acquisition, LLC, Morris Cogenerative, and NRG Audrain Generating LLC; Mirant Americas Energy Marketing, LP, Mirant State Line Ventures Inc., Mirant Zeeland LLC, and Mirant Neenah LLC, AES NewEnergy Inc.; Constellation Power Source, Inc., and its affiliates University Park LLC, Wolf Hills Energy, LLC, and Holland Energy LLC, PG&E National Energy Group Company; Orion Power MidWest, L.P.; El Paso Merchant Energy, L.P.; Tenaska, Inc.; Calpine Corporation; and Public Service Electric and Gas Company, PSEG Power LLC and PSEG Energy Trade & Resources LLC (collectively, Competitive Coalition)

PSEG

Public Service Commission of the Commonwealth of Kentucky (Kentucky Commission)

Reliant Energy Power Generation, Inc. (Reliant)

Trans-Elect

Virginia State Corporation Commission, the Michigan Public Service Commission, West Virginia Public Service Commission, the Indiana Office of Utility Consumer Counselor, the Missouri Office of the Public Counsel, the Ohio Consumers' Counsel, the Coalition of Midwest Transmission Customers, Industrial Energy Users-Ohio, West Virginia Energy Users group, Citizens Action Coalition of Indiana, Inc., the Izaak Walton League of America, Inc., the Environmental Law and Policy Center, and the Association of Business Advocating Tariff Equity (collectively, Joint Protestors)

Virginia State Corporation Commission (Virginia Commission)

Wabash Valley Power Association (Wabash Valley)

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

National Grid USA

Docket No. EL01-80-000

Alliance Companies, et al.

Docket Nos. RT01-99-005, RT01-88-012,
ER99-3144-013, ER99-3144-015, EC99-80-013,

and EC99-80-015

(Issued December 20, 2001)

Breathitt, Commissioner, dissenting in part:

The basis underlying the Commission's action in this order is the majority's conclusion in Alliance Companies, et al., Docket Nos. RT01-88-000, et al., that Alliance Companies lack sufficient size and scope to exist as a stand-alone RTO, and the direction for the Alliance Companies to explore how their business plan can be accommodated within the Midwest ISO. Therefore, for the reasons set forth in my dissent in Alliance, I dissent, in part, on this order as well.

Given the underlying circumstances, however, I agree with the majority that it is appropriate to provide guidance to National Grid. In particular, I support the finding that National Grid is not a market participant with respect to its last resort sales and other obligations in New York and New England.

Linda K. Breathitt
Commissioner